

B. Firms in Regulated Industries Are
Uniquely Affected by the Implementa-
tion of SFAS 106.

AT&T contends that the effect on GNP-PI of implementing SFAS 106 is understated because firms in unregulated sectors of the economy will also be able to reflect those expenses in prices.^{58/} This particular criticism of the NERA Study is unfounded.^{59/} AT&T claims that, because of the uncertainty surrounding the magnitude of the effect of SFAS 106, unregulated firms have not fully reflected SFAS 106 in their prices. However, implementation of SFAS 106 will not change any economic costs.^{60/} Because economic costs are not changing, AT&T's assertion could only be true if prices in competitive markets are not based upon economic costs and competitive markets are not efficient. AT&T provides absolutely no support for either assertion. NERA's theory as to pricing behavior in competitive markets remains essentially

^{58/} Id.

^{59/} Ad Hoc and AT&T also find fault with the NERA Study for failing to account for any input price effects on companies that purchase goods and services from regulated and cost plus firms that may reflect SFAS 106 expense in their prices. AT&T Opposition, App. C at 2-5; Ad Hoc Opposition at 22-24. What both parties fail to note is that such second order effects are likely to be so insignificant as to constitute a rounding error. Indeed, both choose not to offer any quantification of such effects. To this extent, the Commission may safely assume that the magnitude of any second order effects would be minuscule.

^{60/} E.g., Rochester Direct Case at 18-19.

unchallenged. Therefore, there is no reason to believe that the implementation of SFAS 106 will be broadly reflected in GNP-PI.

In addition, the complaint that NERA's calculations are merely "back of the envelope"^{61/} is meaningless. NERA's approach is logically correct as are its estimates of the relative sizes of the regulated and unregulated sectors of the economy.^{62/} As a result, the Commission may appropriately use NERA's estimates of the effects of the implementation of SFAS 106 on GNP-PI in determining the level of incremental OPEB expense that may be recovered through an exogenous cost adjustment.

C. The Commission Should Decline To
Adopt the "Remedies" Proposed in the
Oppositions.

The opponents have noted that the benefit plans and the actuarial assumptions set forth in the Direct Cases vary widely. As a result, they assert, the expense projections are speculative and warrant rejection.^{63/} AT&T further suggests that the Commission mandate the use of uniform external assumptions -- health care inflation, discount rate and return on plan assets -- and assumptions regarding the capping of

^{61/} AT&T Opposition at 13-14.

^{62/} See Rochester Direct Case at 18.

^{63/} Ad Hoc Opposition at 13; AT&T Opposition at 20.

certain types of benefits.^{64/} The Commission should reject these claims.

That OPEB expense projections differ among companies should not be surprising. Different companies offer different benefit plans. As such, divergent expense projections should be expected. However, the existence of such differences itself is not unreasonable. The Commission has previously determined that exchange carriers' initial rates entering price caps were reasonable.^{65/} Because the implementation of SFAS 106 will not itself result in any changes in the level of benefits being provided, the Commission should not mandate the use of particular assumptions regarding further changes in benefit plans.

The Commission should also reject AT&T's request that the amount of OPEB expense recognizable in rates be capped. AT&T claims that such a cap is warranted to prevent exchange carriers from manipulating OPEB expense.^{66/} Ad Hoc claims, in a similar vein, that any recognition of the accounting change is unwarranted because exchange carriers are not contractually

^{64/} AT&T Opposition at 27-29.

^{65/} Second Report and Order, 5 F.C.C. Rcd. at 6817, ¶¶ 251-54.

^{66/} AT&T Opposition at 26-27.

bound to offer OPEBs and may, in the future, reduce the level of their OPEB expense.^{67/}

Those claims lack merit for several reasons. First, they assume that the accounting change will somehow result in an unreasonable level of OPEB expense. Implementation of SFAS 106 only changes what companies must record as current period OPEB expense. It changes neither the level nor the timing of the benefits being offered or provided. Since exchange carriers' rates entering price caps are presumed reasonable,^{68/} there is no basis for capping OPEB expense.

Second, the incentive to manage OPEB expense is neither causally linked to the use of accrual accounting nor is it unique, in a price cap environment, to OPEB expense. Regardless of the accounting method utilized, exchange carriers will have an incentive to manage their OPEB expense. Contrary to the opponents' assumptions, the change from cash to accrual accounting will neither add to nor detract from that incentive.

Moreover, the incentive to manage expenses in a price cap environment is not unique to OPEBs; it is true of every other cost of doing business. Embedded in an exchange carrier's initial price cap rates is a certain aggregate level of

^{67/} Ad Hoc Opposition at 13-14.

^{68/} See supra at 24-25.

expense. One means for an exchange carrier to meet the productivity offset is to control its expenses. That efficiency generating incentive is a key component of price cap regulation and, after recognition of the effect of the accounting change, it would apply to OPEB expense just as it would to any other expense. In addition, as the opponents acknowledge,^{69/} a major purpose of price cap regulation is to avoid embroiling the Commission in controversies over the propriety of particular expenses as it necessarily was under cost of service regulation.

Despite this acknowledgment, the opponents extend this very invitation to the Commission. They assume that, were the Commission to grant exogenous cost treatment to the implementation of SFAS 106, it would need to engage in a continuous review of exchange carriers' OPEB expense. As explained above,^{70/} that is not the case. Rather, the Commission should accord a one-time recognition of the implementation of SFAS 106 and thereafter treat OPEB expense just like any other cost of doing business. Such an approach is consistent with, and indeed compelled by, the Commission's price cap system of regulation.

^{69/} E.g., Ad Hoc Opposition at 16.

^{70/} See supra at 9-11.

The Commission should also reject AT&T's request that the amount of OPEB expense recognizable in rates be limited to the amount that exchange carriers actually fund.^{71/} Regardless of the level of funding, exchange carriers will still be required to record the entire accrued amount as an expense. Moreover, with the various limitations that exist on tax effective funding vehicles, it is likely that exchange carriers may not be able to fund, on a tax effective basis, the full amount of their OPEB expense in any particular year. Adoption of AT&T's proposal could effectively preclude exchange carriers from recovering some portion of an expense that they have been required to recognize. This result is neither fair nor necessary. The Commission should not require exchange carriers to recognize an expense and then to deny recovery of that expense. In addition, to the extent that the level of OPEB expense exceeds the amount funded, the difference operates as a deduction from rate base. Thus, AT&T's proposal is not necessary to protect ratepayers. The Commission should reject this request.

Finally, the Commission should not, as AT&T suggests, require the use of uniform actuarial assumptions.^{72/} The reasonableness of particular assumptions will depend upon a

^{71/} AT&T Opposition at 14-16.

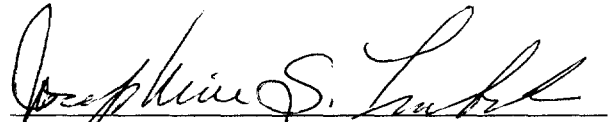
^{72/} Id. at 27-28.

variety of factors unique to individual plans. Moreover, SFAS 106 requires the use of a company's best estimates in developing its actuarial assumptions. AT&T, on the other hand, appears merely to have chosen those assumptions that produce the lowest possible number. AT&T, however, offers no justification for this approach or for the particular assumptions it wants the Commission to mandate. On this basis, there is no reason for the Commission to mandate the use of any particular actuarial assumptions, especially those suggested by AT&T.

Conclusion

For the foregoing reasons, the Commission should accord exogenous cost treatment to Rochester's incremental SFAS 106 expense as requested herein and in Rochester's Direct Case.

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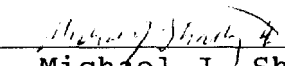
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July 30, 1992

(2898F)

CERTIFICATE OF SERVICE

I hereby certify that on the 30th day of July, 1992, I caused copies of the foregoing Rebuttal To Oppositions To Direct Case of Rochester Telephone Corporation to be served on all of the parties on the attached Service List by depositing same with the United States Post Office, postage prepaid, first class mail.



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